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Federal Budget 2003-04: Postponing the Goal of a Balanced Budget

In view of the tax reform envisaged for 2004-05 and of the sluggish economy the federal government has postponed the achievement of a balanced budget beyond 2007. Regarding its medium-term strategy, fiscal policy will focus on a reduction of the revenue and expenditure ratios. The budgets for 2002 and 2003 have a slightly expansionary impact, while for 2004 a rather contractive effect must be expected. The long-term upward trend in transfers as a share in overall expenditures will be stopped in 2004. Direct taxes are becoming less and less important.

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The federal budget for 2002 aimed at balancing the budgets for all levels of government. With its stability programme for 2003-2007 the federal government has now postponed the achievement of a balanced budget beyond the year 2007. In the medium-term, fiscal policy will focus on reducing the revenue and expenditure ratios, and on re-structuring revenues and expenditures. For the revenue side, the two-stage tax reform of 2004-05 will play an important role, with its first stage impacting the budget for 2004. On the expenditure side, a pension reform that aims at a long-term reduction of federal expenditures has been passed. In addition, the privatisation of public enterprises is to be accelerated.

The following pages will illustrate the extent to which these goals are achieved in the federal budgets for 2003 and 2004. In light of the weakness of the economy and of the current structural policy requirements, an assessment of the federal proposals has also to evaluate the actual cyclical effects of the budgets for 2003-04, as well as measures to stabilise the business cycle and to improve the structure of the economy.

Fiscal policy is currently facing a difficult economic environment and substantial uncertainties. A sustained economic upturn, a necessary condition for budget consolidation, is still not in sight. At the same time fiscal policy is required to provide incentives to stimulate the economy, and thus to avoid an overly restrictive course which would place an additional burden on economic recovery. As long as the growth rate of the Austrian economy remains sluggish, it is appropriate to tolerate the effects of the automatic stabilisers, and to accept the resulting higher deficits. This is a defining trait of the budgets for 2002 and 2003, where no attempts were made to compensate the cyclical shortfall of revenues by tax increases or expenditure cuts that would have negatively affected overall demand. Accordingly federal budgetary policy for 2002 and 2003 has a slightly expansionary impact. For 2004 a rather contractive overall effect must be expected, however.

Revenues net of self-balancing items fell from € 57.82 billion in 2001 to € 57.54 billion in 2002¹. A further decrease to € 56.89 billion is expected for 2003. Only in 2004 modified revenues are projected to increase to € 58.72 billion. Adjusted expenditures

¹ Because of space limitation, and for the sake of greater clarity, the budget for 2002 will not be discussed in a systematic way in this paper (for details see *Lehner, 2001*).

**A temporary deviation
from fiscal
consolidation**

were € 59.93 billion in 2002; they will rise to € 60.83 billion in 2003 and to € 62.15 billion in 2004.

Table 1: Federal budgets for 2001 to 2004

	2001 Outturn	2002 Preliminary outturn Million €	2003 Draft budget	2004 Draft budget	2002 Preliminary outturn Percentage change from previous year	2003 Draft budget	2004 Draft budget
General budget							
Expenditures	60,409	61,803	61,355	62,666	+2.3	-0.7	+2.1
Revenues	58,995	59,413	57,414	59,236	+0.7	-3.4	+3.2
Balance	- 1,415	- 2,390	- 3,941	- 3,430			
Adjustment budget							
Expenditures	37,114	34,697	51,276	50,993	- 6.5	+47.8	-0.6
Revenues	38,529	37,087	55,217	54,423	- 3.7	+48.9	- 1.4
Balance	+ 1,415	+ 2,390	+ 3,941	+ 3,430			

Source: Federal Ministry of Finance. With the outsourcing, in 2004, of universities, expenditures and revenues will each be increased by € 730 million.

Table 2: Modified federal expenditures and revenues

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget
	Million €			
General budget expenditures	60,409	61,803	61,355	62,666
Minus Self-balancing items	- 1,178	- 1,874	- 528	- 519
Adjusted expenditures	59,232	59,929	60,828	62,147
General budget revenues	58,995	59,413	57,414	59,236
Minus Self-balancing items	- 1,178	- 1,874	- 528	- 519
Adjusted revenues	57,817	57,539	56,887	58,717
Balance	- 1,415	- 2,390	- 3,941	- 3,430

Source: Federal Ministry of Finance, WIFO calculations.

Whereas in 2001 the Austrian budget for all levels of government showed a slight surplus of 0.3 percent of GDP, and therefore a positive Maastricht balance², in 2002 it returned to the red (with € -1.2 billion, or -0.6 percent of GDP³). The failure to attain a balanced budget resulted mainly from the unexpected weakness of the economy, which led to lower tax revenues and generated additional expenditures. In addition the budget balance has been significantly affected by the advancement of tax payments following the introduction of interest payments on tax arrears as well as by expenditures connected to the flood in the summer of 2002.

The federal government expects a general government budget deficit of 1.3 percent of GDP (€ 2.85 billion) for the current year, and of 0.7 percent of GDP (€ 1.59 billion)⁴ for 2004. The government is still aiming at long-term fiscal consolidation, with the final goal of a balanced budget. However, this goal is now to be achieved at the end of the business cycle only. According to the current stability programme, and taking into account the planned tax reform, this will be in 2008 at the earliest.

² The Maastricht balance comprises the budgets at federal, state and municipal government levels, as well as social security institutions, funds and municipal associations; it is the target parameter defined in the European Stability and Growth Pact.

³ This preliminary result was adjusted to 0.2 percent after completion of the article.

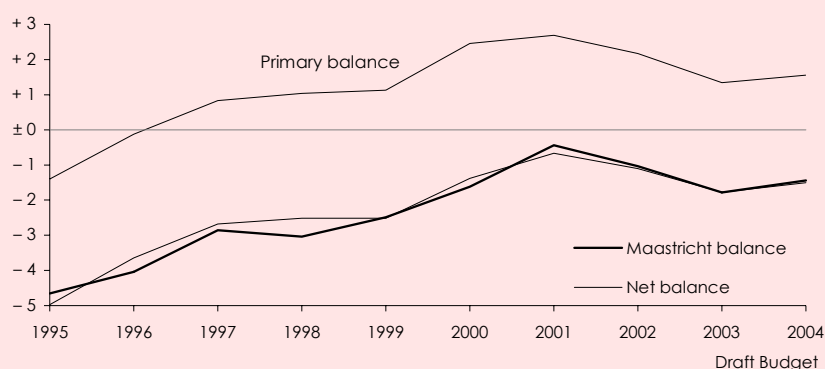
⁴ According to the WIFO projection of September 2003, the budget deficit will be 1.0 percent of GDP in 2003, and 1.2 percent of GDP in 2004.

Fiscal policy is currently facing a difficult economic environment. A marked economic upturn, a necessary condition for budget consolidation, is still not in sight. From a business cycle point of view it is therefore appropriate to tolerate the effects of the automatic stabilisers, and to accept the resulting higher deficits. In accordance with this line of thought the budgets for 2002 and 2003 did not attempt to compensate the cyclical shortfall of revenues by tax increases or expenditure cuts that would have affected overall demand negatively. On the other hand, a rather contractive effect must be expected from the budget for 2004.

Attempt to balance budget failed

Figure 1: Federal budget balances

As a percentage of GDP



Source: Federal Ministry of Finance. WIFO calculations.

The national stability pact for Austria, which was agreed upon by federal, state and municipal governments in 2001, provided for a federal deficit of not more than 0.75 percent of GDP for 2002 (as well as for 2003 and 2004), according to the concept of the European national accounts system. The Länder (states), Vienna included, committed themselves to achieve a yearly average surplus of at least 0.75 percent of GDP during the period 2001 to 2004. The municipalities, Vienna excluded, were to produce balanced budgets at the state level. The fact that budgets for all levels of government could not be balanced in 2002 is due, firstly, to the unexpectedly high deficit at the level of the federal government (a Maastricht balance of -1 percent of GDP). Secondly, the states generated a budget surplus of merely 0.3 percent of GDP, and thus failed to fulfil their commitment under the stability pact. The municipalities, on the other hand, produced a slight surplus (0.2 percent of GDP⁵). The social security institutions managed to balance their budgets.

Table 3: Financing balance and debt position of EU countries

	Financing balance		Debt position	
	2001	2004 Forecast	2001	2004 Forecast
	As a percentage of GDP			
Belgium	+ 0.4	- 0.1	108.5	98.9
Denmark	+ 3.1	+ 2.1	45.4	39.9
Germany	- 2.8	- 2.9	59.5	63.0
Greece	- 1.4	- 1.0	107.0	97.0
Spain	- 0.1	- 0.1	56.9	50.5
France	- 1.5	- 3.5	56.8	63.1
Ireland	+ 1.1	- 0.9	36.8	33.3
Italy	- 2.6	- 3.1	109.5	104.7
Luxembourg	+ 6.4	- 1.2	5.6	3.4
The Netherlands	+ 0.1	- 2.4	52.8	52.8
Austria	+ 0.3	- 0.4	67.3	66.8
Portugal	- 4.2	- 3.2	55.6	60.2
Finland	+ 5.1	+ 3.0	43.8	41.4
Sweden	+ 4.5	+ 1.2	54.4	49.5
UK	+ 0.8	- 2.5	39.0	39.8
EU 15	- 0.9	- 2.2	63.0	63.2
Euro zone	- 1.6	- 2.4	69.2	69.6

Source: European Commission, notification of spring 2003. 2003: spring forecast.

⁵ This preliminary result was adjusted after completion of the article to -0.9 percent for the federal government, 0.4 percent for the states and 0.3 percent for the municipalities.

In comparison to the other countries of the Euro zone, Austria is progressing towards budget consolidation at an above-average pace. In 2001 the Austrian budget balance (a surplus of 0.3 percent of GDP) was already noticeably better than the Euro zone average, which recorded an overall negative net balance of 1.6 percent of GDP. For 2004 the European Commission forecasts an even greater gap: an Austrian net borrowing position of 0.4 percent of GDP, as compared to a Euro zone average deficit of 2.4 percent of GDP⁶. Compared to the group of small EU countries, in 2004 Austria will improve its position of 2001, when the Austrian budget surplus was lower than that of most other countries.

The Federal Budget for 2002 to 2004 – An Overview

Preliminary outturn for 2002

The preliminary outturn of the general budget for 2002 shows expenditures of € 61.8 billion and revenues of € 59.41 billion. This corresponds to a deficit of € 2.39 billion, i.e., 1.1 percent of GDP (0.7 percent of GDP in 2001, 1.4 percent of GDP in 2000). During the year 2002, budgeted federal expenditures and revenues were exceeded by € 2.43 billion and € 0.87 billion, respectively. As a consequence, the federal balance was higher by € 1.56 billion than initially envisaged. The federal Maastricht balance was –1 percent of GDP. This unexpectedly high budget deficit is due, on the one hand, to the weak overall economic situation, which resulted in a loss of tax revenue, higher spending for unemployment benefits, and increased federal contributions to pension insurance schemes; on the other hand, to the costs associated with the flood disaster in the summer of 2002.

Draft budget for 2003

The federal draft budget for 2003 projects expenditures of € 61.36 billion and revenues of € 57.41 for the general budget. Hence both expenditures (–0.7 percent with respect to the previous year) and revenues (–3.4 percent) are lower than in 2002. The deficit in the general budget will reach € 3.94 billion (1.8 percent of GDP), and therefore will be significantly higher than in 2002. The federal Maastricht balance is expected to rise to –1.8 percent of GDP. On the revenue side this estimated deficit increase is the result of cyclically determined low tax revenues and tax breaks granted within the framework of the economic stimulus packages. On the expenditure side, the additional spending for flood relief, the deteriorating labour market situation and increased spending on family benefits and pensions have impacted the deficit negatively.

Draft budget for 2004

The federal draft budget for 2004 envisages expenditures of € 62.67 billion, and revenues of € 59.24. Thus, expenditures (+2.1 percent compared to 2003) and revenues (+3.2 percent) are projected at a higher level than in the previous year, resulting in a reduction of the federal budget deficit to € 3.43 billion (1.5 percent of GDP). The revenue side improves thanks to a slight rebound of income and corporate tax receipts, and, above all, thanks to increased revenues from consumption taxes. Accordingly the federal Maastricht balance drops to –1.4 percent of GDP.

In light of the current theoretical and political discussion⁷ about the purpose and future of the European Growth and Stability Pact, and of the massive deficit problems experienced by some large countries (Germany, France, Italy), at the end of 2002 the Ecofin Council and the European Commission decided to assess the national stability programme⁸ not on the basis only of the current, but also of the structural⁹ Maastricht deficit.

⁶ The projections made by federal government, WIFO and the European Commission diverge from each other because they are based on different growth expectations.

⁷ See, e.g., Breuss (2002) or Buti –Eijffinger –Franco (2003).

⁸ Every country of the Euro zone has to submit a stability programme to the Ecofin Council yearly. This programme describes the medium-term fiscal strategy aimed at fulfilling the commitments stipulated within the European Growth and Stability Pact of 1997.

⁹ Depending on the definition used, the structural deficit is computed by adjusting the current deficit for cyclical influences, and, if applicable, for one-off special effects in the area of revenues and expenditures and the "permanently acceptable" (i.e., investment-oriented) public deficit (e.g., according to the definition used by the German Council of Economic Experts, 2001). However, the national stability programmes which have to be submitted to the Ecofin Council are only required to perform a cyclical adjustment.

Institutional Changes and Special Factors

In the preliminary outturn for 2002 as well as in the budgets for 2003 and 2004 balances and components of expenditure and revenue are affected by various institutional changes and special factors: the outsourcing of the universities, the abolition of the 13th V.A.T instalment and the flood disaster in the summer of 2002. Shifts in competences and thus between budget chapters do not influence the economic structure of expenditures and revenues, and are therefore not taken into account here.

The structural deficit is a more adequate indicator than the current net balance for assessing the need for fiscal consolidation. In fact, if automatic stabilisers are allowed to act unhindered, and if discretionary anti-cyclical and expansionary measures are implemented, the current net balance is likely to be significantly affected by the cyclical pattern. The structural deficit as key indicator for long-term sustainability should avoid an overestimation of the cyclical effects on the deficit. Thus a pro-cyclical fiscal policy that would further aggravate an existing crisis can be prevented. In 2002 the Austrian structural deficit was 0.4 percent of GDP. According to the stability programme of March 2003, the structural deficit will be 0.9 percent this year and 0.4 percent in 2004. As a consequence of the planned second stage of the tax reform for 2004-05 the structural deficit is likely to rise to 1.3 percent of GDP in 2005, and improve only gradually over the next two years (to 0.5 percent of GDP in 2007).

Table 4: Consolidation path under the stability programme

	2002	2003	2004	2005	2006	2007
	As a percentage of GDP					
Actual budget balance ¹	- 0.6	- 1.3	- 0.7	- 1.5	- 1.1	- 0.4
Structural budget balance ¹	- 0.4	- 0.9	- 0.4	- 1.3	- 1.1	- 0.5
Public debt	67.8	67.0	65.1	63.8	62.1	59.7

Source: Federal Ministry of Finance, Austrian Stability Programme 2003-2007. – ¹ Including tax reform and swap operations.

As a consequence of two recent decisions by the EU's statistical office (Eurostat), the overall level of public debt as a percentage of GDP had to be revised upwards substantially:

- Government bonds issued in order to finance public entities (the financing of public undertakings – Rechtsträgerfinanzierung¹⁰ – which was put in place in 1998) have to be included in the gross debt position. This entails an upward revision of government debt for the year 2002 by € 11.7 billion.
- To this, € 2.6 billion are added from a securitisation operation set up by the Land Niederösterreich (the state of Lower Austria) in connection with the sale of its mortgage loan portfolio. As a consequence, in 2002 the debt ratio rose to its highest level ever, reaching 67.9 percent of GDP.

As a result of this statistical revision and of the rise in net borrowing in the course of budget execution, in 2002 it was not possible to depress the debt ratio below the reference value of 60 percent of GDP established in the European Growth and Stability Pact as previously planned. On the contrary, this target is expected to be reached not before 2007. According to the proposed budgets, the debt ratio will decline to 67.1 percent of GDP this year, and to 66.5 percent of GDP in 2004. Despite the statistical revision, in 2001 the Austrian debt ratio of 67.3 percent of GDP was clearly below the average of the Euro zone (69.2 percent of GDP). In accordance with the EU projections for 2004, this gap will increase in 2004. Thus, Austria's budget situation is comparably favourable and there is some leeway for implementing measures designed to stabilise the business cycle.

¹⁰ The financing of public undertakings (Rechtsträgerfinanzierung) involves loans taken out by the Austrian Federal Financing Agency for ÖBB, SCHIG, ASFINAG, Austro Control and Museumsquartier. This is done in order to obtain favourable interest rates.

Statistical revision of the debt ratio

Whether it will be possible to adhere to the course of fiscal consolidation that has been sketched in the budgets for 2003-04, will depend mainly on the development of business conditions. At present, indicators point to only a slight improvement of the economic situation in the year 2004. Thus, given the effects of the automatic stabilisers, the target of a budget deficit at 0.7 percent of GDP in 2004, which relies on a real growth rate of 1.7 percent, could be missed. In its economic outlook for 2004, released in September 2003, WIFO expects the Austrian GDP to grow by 1.4 percent, and the Maastricht balance to reach -1.2 percent of GDP. The deterioration of growth perspectives for 2003, which results primarily from weak exports, will have a lagged impact on direct taxation receipts in the year 2004. However, there is a certain margin for improving the projected federal budget balance with one-off measures (such as the liquidation of reserves) or with the reduction of discretionary expenditures.

The development of the business cycle in the medium term, together with the nominal interest rate for net borrowing and the primary budget balance¹¹, is a decisive determinant of the success of the planned reduction of the debt ratio. The level of primary surplus required to stabilise or even reduce the total debt burden is given by the level of total debt and by the difference between nominal interest rate for net borrowing and GDP growth rate. In light of the projected nominal GDP growth rate (2003 +2.6 percent, 2004 +2.7 percent), the primary budget balances envisaged by the budgets for 2003-04 will not be sufficient to cut debt below the targeted level. On the other hand, the expected decline of the nominal interest rate will have a positive effect. Furthermore, the legal entities (Rechtsträger) whose debt is included in total public debt will not incur additional deficits, but will rather reduce their debts to zero by 2012.

Table 5: Budget balance components

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004
	Million €			
Balance of current transactions	+ 5,611	+ 3,707	+ 434	+ 2,409
Investments and property acquisitions	+ 342	+ 401	+ 129	- 117
Capital transfers (net)	- 5,716	- 5,838	- 5,676	- 5,987
GDP-relevant balance	+ 237	- 1,730	- 5,114	- 3,695
Balance of contributions to capital formation	- 365	- 77	- 49	- 40
Allocation to reserves (net)	- 1,286	- 583	+ 1,222	+ 305
General budget balance	- 1,415	- 2,390	- 3,941	- 3,430
Interest (except currency swaps)	+ 7,107	+ 7,099	+ 6,907	+ 6,960
Primary balance	+ 5,693	+ 4,709	+ 2,966	+ 3,530

Source: Federal Ministry of Finance, WIFO calculations.

The GDP-relevant budget balance is better suited for evaluating the effects of the budget on the business cycle than the administrative balance. It is calculated by adjusting the administrative balance for (net) contributions to capital formation and reserves. In 2002 the GDP-relevant budget balance was € -1,730 million, slightly more than scheduled. For 2003 it is projected to jump to € -5,114 million, which should have an expansionary effect on total demand. This increase can be traced back primarily to the effect of the automatic stabilisers. The expected decrease of the GDP-relevant budget balance for 2004 (to € -3,695 million), which is due to receipts growing faster and expenditures growing more slowly than nominal GDP, should have a contractionary impact, however. If the time lag in tax revenues that has

¹¹ The underlying relationships can be expressed by the following equation:

$$\Delta \frac{D}{Y} = (i_t - g_t) \frac{D_{t-1}}{Y_{t-1}} - \frac{P_t}{Y_t}$$

i . . . average interest rate for public debt, g . . . growth rate of GDP from previous year, nominal, D . . . total public debt, Y . . . GDP, nominal, P . . . primary budget balance (for details see Lehner, 2001).

been caused by the abolition of the 13th V.A.T. instalment is taken into account, a slightly expansionary effect can be made out for 2003 and 2004. Particularly the administrative budget balance for the year 2003 is considerably improved by the large-scale dissolution of reserves (€ 1,222 million net).

The federal government's policy of reducing both the overall tax ratio (taxes and social security contributions over GDP) and the expenditure ratio in the medium term shows up in the budgets for 2003 and 2004. In the year 2002 a slight reduction in the tax ratio was achieved, with a decline from 45.6 percent of GDP in 2001 to 44.6 percent¹². Under the current stability programme a further reduction is planned for the years 2003 (44.4 percent) and 2004 (44.1 percent). By 2007 the overall tax ratio is to drop to 42.9 percent of GDP. These figures do rely, however, to a certain extent on special effects (the introduction of interest charged for tax arrears). Over the same period, a gradual reduction of the expenditure ratio from 52 percent of GDP in 2001 to 49.8 percent of GDP in 2007 is targeted.

Revenues and expenditures shaped by the goal of reducing the expenditure and revenue ratio

Table 6: Expenditure and revenue ratios

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004
	As a percentage of GDP			
<i>Expenditures</i>				
Production of goods	7.7	7.4	7.5	7.0
Staff costs, including teachers at state level, excluding postal service staff	4.6	4.5	4.5	4.2
Staff costs for the postal service	0.5	0.5	0.5	0.4
Operating expenses	2.3	2.3	2.4	2.3
Investments	0.2	0.2	0.1	0.1
Acquisition of properties and titles which can be capitalised	0.0	0.0	0.0	0.0
Transfer expenditures	10.4	10.5	10.7	10.5
Financing	9.9	9.7	9.3	9.8
Interest payments	3.8	3.9	3.7	3.6
Other	6.0	5.8	5.6	6.3
General budget expenditures, adjusted	28.0	27.7	27.5	27.3
<i>Revenues</i>				
Taxes (net)	17.9	16.9	16.0	17.0
Tax-like revenues	4.1	4.1	4.2	4.2
Other	5.3	5.6	5.5	4.6
General budget revenues, adjusted	27.3	26.6	25.7	25.8
Balance	-0.7	-1.1	-1.8	-1.5

Source: Federal Ministry of Finance, WIFO calculations. GDP as per WIFO projection of June 2003.

As part of the overall target of reducing the size of the public sector, a long-term reduction of the federal expenditure and revenue ratios is envisaged. The budgets for 2003-04 reflect this goal by providing for a reduction of non-wage labour costs as of 2004, for the first stage of the tax reform in 2004, for the pension reform in 2003 and for the outsourcing of universities. The revenue ratio is due to fall in 2003, and then to rise in 2004. The expenditure ratio should decline steadily between 2001 and 2004.

As part of the strategy to reduce the size of the public sector, both federal expenditure and revenue ratios are to decline in the long term. Within the budgets for 2003-04, the reduction in non-wage labour costs of older workers as of 2004¹³, and, foremost, the tax cuts agreed upon as first stage of the tax reform for 2004-05, the pension reform for 2003, and the outsourcing of universities contribute towards this goal.

In 2003 adjusted federal revenues are expected to fall to 25.7 percent of GDP (as against 27.3 percent in 2001). This decline in the revenue ratio results from an absolute fall in revenues between 2001 and 2003, which can be traced back primarily to the decrease in net tax receipts (the tax revenues which remain with the federal government). This development is also connected to the abolition of the 13th V.A.T.

Revenue ratio to rise again in 2004

¹² Including payments to the EU.

¹³ The following social security contributions have been reduced: accident insurance contributions, employers' contributions to the Family Burden Equalisation Fund and to the Insolvency Fund for workers over the age of 60, as well as the employers' contributions to unemployment insurance for workers over the age of 56 and 58, respectively.

instalment. For 2004, the revenue ratio is expected to increase once again by a small amount.

On the contrary, the targeted reduction in the federal expenditure ratio from 28 percent in 2001 to 27.3 percent in 2004 does not result from an absolute decline in adjusted expenditures. This trend is rather due to the fact that spending is likely to grow at a rate that is lower than the nominal GDP growth rate assumed in the federal budgets. Particularly the expenditure ratio for the provision of public services (especially staff expenditures, since the investment ratio is at a historical low anyway) will fall markedly (from 7.7 percent in 2001 to expected 7 percent in 2004), mainly due to the outsourcing of universities. On the other hand, the share of transfer expenditures in GDP has increased from 10.4 percent to 10.7 percent between 2001 and 2003, and according to the federal budget, is set to fall slightly to 10.5 percent in 2004. Finally, financing expenditures will drop slightly between 2001 and 2004 (from 9.9 percent to 9.8 percent of GDP). This will happen in spite of the fact that starting with 2004 the universities will be included in this expenditure component.

The revenue and expenditure sides contribute in different ways to the current budget balance. The rise in the deficit observed between 2001 and 2003 was mainly determined by the fall in the revenue ratio, which more than offset the consolidating effect of the slightly declining expenditure ratio. In 2004 the deficit will decrease, because the revenue ratio is expected to grow faster than the expenditure ratio. In this year, the increase in expenditures for the provision of public services and for transfers, which will remain below the nominal GDP growth rate, will contribute to consolidation. Conversely, financing expenditures will place a larger burden on the budget. On the revenue side, net tax receipts will support budget consolidation in 2004.

From 2001 to 2004 the expenditure structure at the federal level will change significantly. *Transfers* are the only expenditure item that will grow throughout this period, increasing even in real terms in 2002 and 2003. The upward drive in 2002 and 2003 is mainly due to the increase in family benefits and in spending for unemployment benefits and pensions. Overall, transfer expenditures are up from € 22 billion in 2001 to € 23.9 billion in 2004. Their share in total expenditures is expected to grow continuously between 2001 (37.2 percent) and 2003 (39.1 percent). This trend is likely to be reversed in 2004: by then transfers will account for 38.5 percent of total expenditures.

Continuous fall of the expenditure ratio

A minor change in the expenditure structure

Upward trend of transfer expenditures share to be halted in 2004

Table 7: Economic breakdown of expenditures

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget	2002 Preliminary outturn	2003 Draft budget	2004
	Million €				Percentage change from previous year		
Production of public goods	16,313	16,095	16,510	15,891	- 1.3	+ 2.6	- 3.7
Transfers	22,042	22,849	23,807	23,900	+ 3.7	+ 4.2	+ 0.4
Financing	20,878	20,985	20,510	22,356	+ 0.5	- 2.3	+ 9.0
Total	59,232	59,929	60,828	62,147	+ 1.2	+ 1.5	+ 2.2
	As a percentage of total expenditure						
Production of public goods	27.5	26.9	27.1	25.6			
Transfers	37.2	38.1	39.1	38.5			
Financing	35.2	35.0	33.7	36.0			
Total	100.0	100.0	100.0	100.0			

Source: Federal Ministry of Finance, WIFO calculations.

In 2004 the long-term trend towards an increase in the share of transfer expenditures in total federal expenditures will come to a halt because spending on old-age pensions will decline. Correspondingly in 2004 also the share of old-age pensions spending in transfer expenditures will shrink. Family benefits, on the other hand, will rise. While the relative importance of financing expenditures increases, expenditures for the provision of public services will fall as a share of overall federal spending. There will be an only modest upturn in expenditures on R&D.

After a yearly average increase in transfer expenditures for old-age pensions of 4.3 percent in the period between 2001 and 2003, the budget for 2004 projects a reduction of 0.9 percent compared to the 2003 budget. The rise in direct pension expenditures (with the exception of the pensions for postal service employees),

modest compared to previous years, is more than compensated by the noticeable cut in contributions to the pension insurance schemes (–3.8 percent). This reflects primarily the savings effects of the pension reform of 2000, while the pension reform of 2003 contributes to a lesser extent to the reduction in federal grants.

Table 8: Transfer expenditures

	2001 Outturn	2002 Preliminary outturn Million €	2003 Draft budget	2004 Draft budget	2002 Preliminary outturn Percentage change from previous year	2003 Draft budget	2004
Old-age pensions	13,001	13,689	14,149	14,021	+ 5.3	+3.4	– 0.9
Pensions for federal civil servants, state teachers, employees of federal railway and postal services	6,014	6,226	6,426	6,588	+ 3.5	+3.2	+ 2.5
Contributions to pension insurance institutions ¹	6,987	7,463	7,724	7,433	+ 6.8	+3.5	– 3.8
Families	3,363	3,684	4,059	4,168	+ 9.5	+10.2	+ 2.7
Family allowances ²	2,803	2,826	2,976	2,978	+ 0.8	+5.3	+ 0.1
Parental leave benefits, child-care benefits	559	858	1,083	1,190	+53.4	+26.2	+ 9.8
Unemployment benefits	1,889	2,135	2,188	2,230	+13.1	+2.4	+ 1.9
Long-term care benefits	1,290	1,294	1,333	1,350	+ 0.3	+3.0	+ 1.3
Other	2,499	2,047	2,078	2,131	–18.1	+1.5	+ 2.5
Total	22,042	22,849	23,807	23,900	+ 3.7	+4.2	+ 0.4

Source: Federal Ministry of Finance, WIFO calculations. – ¹ Including equalisation allowances and transfers to the compensation fund of the pension insurance institutions. – ² Including child-birth benefits and school commuting grants.

In 2004, net spending on pensions – federal expenditures minus pension-related revenues, such as contributions by federal employees or contributions by the postal and railway services – is also expected to fall. Since pension-related revenues will change only marginally between 2001 and 2004, net spending on pensions will rise markedly between 2001 and 2003, but will fall by 1.6 percent in 2004.

Family benefits, which represent the second largest item in transfer expenditures, experience an above-average increase between 2001 and 2004. This development results primarily from the introduction of child-care benefits to replace the parental-leave allowances in 2002. With this measure, the group of individuals eligible for benefits has been enlarged significantly, and higher benefits are granted over a longer maximum period of time. Spending on parental-leave allowances and child-care benefits has increased by 53.4 percent in 2002; it is projected to rise by 26.2 percent and 9.8 percent in 2003 and 2004. The child-care benefit programme will require expenditures of € 864 million in 2003 and € 913 million in 2004.

The rise in spending on family benefits, which has been set at +5.3 percent in 2003, results from the increment of the family allowance for children aged 3 and older. For 2004, the implementation of an additional child allowance for multiple-birth children is planned. Altogether, spending on families within the Family Burden Equalisation Fund is set at € 4,059 million for 2003 and € 4,168 million for 2004. In this light, the resources available through the Family Burden Equalisation Fund and the assets of the Family Allowance Reserve Fund appear insufficient to cover the significant expansion of family benefits, with the result of an additional burden on the federal budget. The Family Burden Equalisation Fund will register deficits of € 230 million in 2003 and € 280 million in 2004, thus possibly requiring the federal government to step in to cover these sums.

Table 9: Federal expenditures on pensions

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget
	Million €				Percentage change from previous year		
Pensions for federal civil servants	2,659	2,750	2,840	2,916	+ 3.4	+ 3.3	+ 2.7
Compensation for pensions paid to state teachers	734	758	795	797	+ 3.2	+ 4.9	+ 0.2
Pensions for federal postal employees	893	972	1,021	1,098	+ 8.8	+ 5.1	+ 7.5
Pensions for federal railways employees	1,728	1,746	1,769	1,777	+ 1.1	+ 1.3	+ 0.5
Contributions to pension insurance	4,460	4,955	5,822	5,875	+ 11.1	+17.5	+ 0.9
Equalisation supplements	878	926	1,107	762	+ 5.5	+19.5	- 31.2
Transfers to the compensation fund of the pension insurance institutions	1,649	1,582	795	797	- 4.1	-49.8	+ 0.3
Total expenditure	13,001	13,689	14,149	14,021	+ 5.3	+ 3.4	- 0.9
Pension contributions paid by the federal employees	562	560	552	551	- 0.5	- 1.4	- 0.3
Contributions as per Section 13 PG	71	75	77	80	+ 5.3	+ 3.0	+ 4.7
Contributions by state teachers	20	21	21	22	+ 3.8	+ 1.6	+ 3.3
Pension contributions, postal service	265	245	216	193	- 7.6	-11.8	- 10.5
Pension contributions, federal railways	434	445	437	426	+ 2.6	- 1.7	- 2.7
Pension security contributions, federal railways	57	61	59	66	+ 6.6	- 2.9	+ 11.7
Other pension-related income	47	58	52	151	+ 23.1	-10.8	+191.3
Total income	1,456	1,464	1,414	1,489	+ 0.5	- 3.4	+ 5.3
Net expenditure on pensions	11,545	12,225	12,735	12,532	+ 5.9	+ 4.2	- 1.6

Source: Federal Ministry of Finance, WIFO calculations.

The most recent changes in the transfer system initiated a structural shift within transfer expenditures. This shift will become more marked in the future. The long-term trend towards an increasing share of spending on old-age pensions will be reversed: the federal budget projects a reduction from 59.9 percent in the year 2002 to 58.7 percent in 2004. The pension reform of 2003 will display its full-scale effects only in the years after 2004, and will then provide for an effective reduction of spending on old-age provisions. On the other hand, family benefits gain in importance: their share in total transfers is expected to increase from 15.3 percent in 2001 to 17.4 percent in 2004.

Table 10: Structure of transfer expenditures

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget
	Percentage shares			
Old-age pensions	59.0	59.9	59.4	58.7
Families	15.3	16.1	17.0	17.4
Unemployment benefits	8.6	9.3	9.2	9.3
Long-term care benefits	5.9	5.7	5.6	5.6
Other	11.3	9.0	8.7	8.9
Total	100.0	100.0	100.0	100.0

Source: Federal Ministry of Finance, WIFO calculations.

By contrast, during the years 2002 to 2004 the share of payments for unemployment benefits (well over 9 percent of total transfers) and long-term care benefits (5.7 percent and 5.6 percent) will remain largely unaffected. The marked increase in payments for *unemployment benefits* in 2002, up by 13.1 percent to € 2,135 million, is a direct consequence of the deterioration of the labour market. Against the background of the current WIFO projections on the development of unemployment, only a modest increase is expected for 2003 and 2004. According to the federal budget, payments for unemployment benefits will amount to € 2,188 million in 2003 (+2.4 percent) and to € 2,230 million in 2004 (+1.9 percent).

After having been curtailed at the end of the 1990s in the wake of the 1996 Structural Adjustment Act, spending on *long-term care benefits* has increased once more over the past years. However this has happened at a low nominal growth rate; only the budget for 2003 projects also a real growth rate. In 2002 spending on long-care benefits amounted to € 1,294 million (+0.3 percent). For 2003 it has been set at € 1,333 million (+3 percent); the relatively strong rise stems from a one-off payment to eligible persons in the higher nursing-need categories. For 2004, expenditures of € 1,350 million (+1.3 percent) have been budgeted. The relative importance of *other transfer expenditures* is diminishing, as spending on war victims and other allowances and subsidies are shrinking.

After only modest increases or even decreases in previous years, financing expenditures, which represent the second largest item of federal expenditures, will experience an above-average growth in 2004 (+9 percent). They are expected to climb to € 22.35 billion (from € 20.88 billion in 2001) in 2004. As a result, the share of financing expenditures in total expenditures, on the decline for many years, is once again clearly on the rise. In 2004 it will represent 36 percent of total expenditures, and thus exceed the corresponding figure for 2001 (35.2 percent). The increase in the year 2004 is mainly due to the outsourcing of the universities (University Act of 2002) in 2004 – the budget for 2004 provides for a lump-sum grant of € 1,703 million to the universities. This new arrangement has a dampening effect on expenditures for the production of public goods.

Financing expenditures gain once more in importance

Table 11: Expenditure on financing

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget	Percentage change from previous year		
	Million €						
Interest payments in the federal public debt ¹	8,080	8,362	8,130	8,111	+ 3.5	- 2.8	- 0.2
Transfers to public entities	6,381	6,921	7,317	9,157	+ 8.5	+ 5.7	+ 25.1
Lump sum to universities				1,703			
Other	6,381	6,921	7,317	7,455	+ 8.5	+ 5.7	+ 1.9
Transfers to enterprises	3,117	3,095	3,581	3,930	- 0.7	+ 15.7	+ 9.8
Expenses for monetary transfers, exchange losses and refunds	218	164	586	233	- 24.8	+ 256.6	- 60.2
Loans granted, acquisition of stakes	637	125	119	119	- 80.4	- 5.2	- 0.0
Allocation to reserves	1,761	1,651	20	0	- 6.2	- 98.8	- 98.7
Other	683	666	758	806	- 2.4	+ 13.7	+ 6.4
Total	20,878	20,985	20,510	22,356	+ 0.5	- 2.3	+ 9.0

Source: Federal Ministry of Finance, WIFO calculations. – ¹ Including currency swaps.

The continuing importance of financing expenditures within total federal spending reflects the consequent outsourcing strategy of the past years, which results in increasing transfers to enterprises and public entities. Interest payments on public debt, which constitute the largest share of financing expenditures, are likely to drop thanks to the low interest rates and the re-financing of old debt contracted with higher interest rates. Interest payments, excluding currency swap operations, will be at € 6.96 billion in 2004, and therefore lower than in 2001.

Expenditures for the *production of public goods* continue on their downward trend. The share of this item in total federal expenditures shrinks from 27.5 percent in 2001 to a budgeted 25.6 percent in 2004. These expenditures are set to decrease in nominal and real terms in 2002 and 2004. The year 2003 is an exception, with the nominal growth rate above the inflation rate. According to the preliminary outturn, expenditures amounted to € 16.1 billion in absolute terms in 2002. The outsourcing of universities, which affects some 6,900 jobs, is the primary determinant of the marked decrease in spending on federal employees in the year 2004 (-4.4 percent). The "real" staff reduction at the federal level, aimed at a further reduction of spending on personnel and planned for the years 2003 and 2004, involves some 5,900 jobs. In 2004

Expenditures for the production of public goods decrease

the outsourcing of universities will also warrant a further pronounced reduction in investment spending, an item that has been declining for years.

Table 12: Spending on the production of public goods

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004	2002 Preliminary outturn	2003 Draft budget	2004
	Million €				Percentage change from previous year		
Staff costs, federal employees	6,950	6,935	7,067	6,754	- 0.2	+ 1.9	- 4.4
Staff costs reimbursement for teachers at state level	2,825	2,810	2,808	2,808	- 0.5	- 0.1	± 0.0
Staff costs for the postal service	1,089	1,016	1,010	1,010	- 6.7	- 0.6	± 0.0
Operating expenses	4,936	4,919	5,344	5,147	- 0.4	+ 8.6	- 3.7
Investments	459	377	271	163	- 17.8	- 28.0	- 39.9
Acquisition of properties and titles which can be capitalised	53	38	10	10	- 28.6	- 74.0	- 0.1
Total	16,313	16,095	16,510	15,891	- 1.3	+ 2.6	- 3.7

Source: Federal Ministry of Finance, WIFO calculations.

The federal budget is thus increasingly turning into a financing budget. The ongoing outsourcing process, which concerns mainly the area of infrastructure, leaves the federal government with less and less leeway to pursue a targeted infrastructure policy. In some sectors this is leading to structural deficits, which may prove harmful to economic growth in the long run.

The federal budgets for 2003 and 2004 did actually announce a focus on R&D, education and infrastructure; however, only minor additional resources have been devoted to these areas. According to the budget, R&D-related expenditures at the federal level in 2003 will overrun those of the previous year by a mere € 8 million, totalling € 1.47 billion (+0.5 percent). For 2004 a rise of € 88 million (+6 percent), to € 1.56 billion, has been planned. The necessary resources will come mainly from the funds of the R&D Strategic Programmes I (2001-2003) and II (2004-2006). On this basis, the federal government's medium-term goal of an increase in the research ratio¹⁴ to 2.5 percent by the year 2006 will hardly be attainable. It is also clear that the private sector would have to make a major contribution if this goal was to be achieved.

The development of federal revenues reflects a retreat of the state from the economy, with a decrease of the government revenue ratio, and also with a continuation of the privatisation policy. The privatisation mandate given to the ÖIAG, Austria's holding and privatisation agency, envisages the sale of almost all federal shares¹⁵ by the year 2006. Since the proceeds from privatisation are to be used to settle the ÖIAG debt, the privatisation policy will not have a direct impact on the federal budget.

The *net tax receipts* (gross tax receipts minus transfers to federal funds, states, municipalities and the EU) will lose in relative importance between 2001 and 2003, falling in 2003 to € 35.44 billion (from € 37.93 billion in 2001), or to 62.3 percent of total federal revenues. Only in 2004 will their share experience once more a marked increase, reaching almost two thirds of total adjusted federal revenues. The net tax receipts are budgeted at € 38.62 billion. This development has its roots, among other things, in the abolition of the 13th V.A.T. instalment.

A clear shift in the tax structure

Tax ratio to rise again in 2004

¹⁴ For 2003 Statistics Austria estimates this figure at 1.96 percent of GDP. The research ratio is given by the relation of all private and public expenditures for R&D to GDP (Scholtze, 2003). At the Lisbon summit of 2000 the EU member states agreed to increase the national research ratios to 3 percent by 2010.

¹⁵ With the exception of OMV and AUA, as well as possibly of the federal postal service.

Table 13: Economic breakdown of revenues

	2001 Outturn	2002 Preliminary outturn	2003 Draft budget	2004 Draft budget	2002 Preliminary outturn	2003 Draft budget	2004
	Million €				Percentage change from previous year		
Taxes (net)	37,933	36,666	35,444	38,616	- 3.3	- 3.3	+ 8.9
Tax-like revenues	8,728	8,838	9,252	9,640	+ 1.3	+ 4.7	+ 4.2
Other	11,156	12,035	12,191	10,461	+ 7.9	+ 1.3	- 14.2
Total	57,817	57,539	56,887	58,717	- 0.5	- 1.1	+ 3.2
	Percentage share						
Taxes (net)	65.6	63.7	62.3	65.8			
Tax-like revenues	15.1	15.4	16.3	16.4			
Other	19.3	20.9	21.4	17.8			
Total	100.0	100.0	100.0	100.0			

Source: Federal Ministry of Finance, WIFO calculations.

At the same time, and mainly as a consequence of the increase in revenues earmarked for settlement water management, *tax-like revenues* gain in importance. For 2004 the share of tax-like revenues in total federal revenues is projected at 16.4 percent, compared to 15.1 percent in 2001. These revenues of the federal government are earmarked; their main components are unemployment insurance contributions, employers' contributions to the Family Burden Equalisation Fund and shares of taxes on income. The budgeted increase for the years 2003 and 2004 stems mainly from the expected strong growth of revenues from unemployment insurance contributions (2003 +8.3 percent, 2004 +4 percent), which lies well above the projected growth in wages and salaries per employee (+2.2 and +2 percent, respectively), and has thus been projected rather optimistically.

After a modest growth in 2003, *other revenues* are expected to experience both an absolute and relative decline in 2004. This development is mainly driven by a shortfall in compensatory payments as well as in revenues from assets and entrepreneurial activities (transfer of profits from the central bank will fall). Nonetheless, other revenues, which account for 17.8 percent of total revenues, remain more important than tax-like revenues.

In view of the goal of effective budget consolidation, the projected increase in tax revenues compared to other types of revenues has to be evaluated positively. In fact, it indicates that financial planning will be able to rely more on stable, long-term revenue sources, and less on one-off measures. However, this trend may well be foiled by the second stage of the tax reform for 2004-05.

In the period from 2001 to 2003 gross tax receipts are scheduled to fall from € 56.21 billion to € 53.76 billion, but the federal budget for 2004 projects a pronounced increase (+7.2 percent) to € 57.62 billion. The gross tax ratio follows a parallel development: first it drops from 26.5 percent of GDP in 2001 to expected 24.3 percent of GDP in 2003, and then, in 2004, is set to grow considerably (by 1 percentage point) to 25.3 percent. Between 2001 and 2003 the gross tax ratio will decline by less than the net tax ratio. This reflects mainly the rhythm of revenue share transfers to states and municipalities.

The decline in tax ratios up to 2003 can be traced to a large extent to the introduction of interest charges on tax arrears. As a result, tax payers paid a large share of their income and corporate taxes for 2000 as early as in 2001; without this change, such payments would have been made as late as in 2002 and 2003. Moreover, the cyclical weakness of the years 2002 and 2003 has resulted in a shortfall in the receipts from income and corporate taxes. Revenues from income and corporate taxation have been further reduced, although on a minor scale, by the tax relief measures adopted in connection with the flood disaster in the summer of 2002. Furthermore, the year 2003 is affected by a series of tax relief measures, some of them

The tax ratios (net as well as gross) will decline up to 2003 as a result of the sluggish economy and of the tax breaks that have been granted within the federal economic stimulus package and as relief payments for the flood disaster in the summer of 2002. For 2004 an increase in the tax ratio is to be expected. The share of tax-like revenues in total federal revenues will rise. Despite a scheduled increase in 2004, environmental taxes do not gain much in importance. In the long term, the burden of the wage tax on income is likely to become larger. Tax revenues rely increasingly on indirect taxation.

one-off (the abolition of the 13th V.A.T. instalment which determines a one-time slash of receipts by € 1.7 billion), some expiring at the end of 2003 (such as the premium on incremental investment included in the economic stimulus package of September 2002), and some granted for an indefinite period of time (within the context of the economic stimulus packages of December 2001 and September 2002).

Table 14: Tax revenues

	2001 Outturn	2002 Preliminary outturn Million €	2003 Draft budget	2004	2002 Preliminary outturn Percentage change from previous year	2003 Draft budget	2004
Taxes on income	28,575	26,672	26,657	27,477	- 6.7	- 0.1	+ 3.1
Assessed income tax	3,987	3,126	2,950	3,000	- 21.6	- 5.6	+ 1.7
Wage tax	15,672	16,219	16,800	17,300	+ 3.5	+ 3.6	+ 3.0
Corporate income tax	6,235	4,559	4,100	4,300	- 26.9	- 10.1	+ 4.9
Withholding tax on investment income, types I and II	2,048	2,123	2,160	2,210	+ 3.7	+ 1.7	+ 2.3
Other	633	644	647	667	+ 1.8	+ 0.4	+ 3.1
Taxes on expenditure and consumption	26,468	27,087	25,970	28,995	+ 2.3	- 4.1	+ 11.6
V.A.T.	17,354	17,639	16,300	19,000	+ 1.6	- 7.6	+ 16.6
Consumption tax	423	415	425	440	- 1.9	+ 2.5	+ 3.5
Mineral oil tax	2,880	3,109	3,230	3,450	+ 7.9	+ 3.9	+ 6.8
Tobacco tax	1,234	1,297	1,350	1,350	+ 5.1	+ 4.1	± 0.0
Tax on alcoholic beverages	296	335	337	337	+ 13.1	+ 0.6	± 0.0
Public charges	798	766	790	800	- 4.0	+ 3.2	+ 1.3
Insurance tax	814	826	850	880	+ 1.4	+ 2.9	+ 3.5
Car engine-capacity related insurance tax	1,117	1,185	1,220	1,250	+ 6.1	+ 3.0	+ 2.5
Energy tax	754	692	640	790	- 8.2	- 7.6	+ 23.4
Other	797	825	828	698	+ 3.5	+ 0.4	- 15.7
Taxes on property	739	676	690	705	- 8.5	+ 2.1	+ 2.2
Taxes on imports	225	219	200	200	- 3.1	- 8.5	± 0.0
Secondary claims and residual receipts	204	298	241	241	+ 46.2	- 19.1	+ 0.1
Gross total	56,210	54,951	53,758	57,618	- 2.2	- 2.2	+ 7.2
Minus transfers to other legal entities	-16,285	- 16,176	-16,214	- 16,602	- 0.7	+ 0.2	+ 2.4
Minus contribution to EU	- 1,992	- 2,108	- 2,100	- 2,400	+ 5.8	- 0.4	+ 14.3
Net total	37,933	36,666	35,444	38,616	- 3.3	- 3.3	+ 8.9

Source: Federal Ministry of Finance, WIFO calculations.

In 2004, the trend towards overall shrinking tax revenues is expected to reverse due to a sharp increase in tax receipts from indirect taxes (especially the V.A.T.). Cash receipts will be up because of the change in the modality of V.A.T. advance payments. Despite the modest development of private consumption expenditures, the V.A.T. intake is expected to develop favourably because measures implemented to combat V.A.T. fraud should improve tax collection substantially.

In 2004 the budgeted figures for tax receipts on expenditure and consumption reflect also a rise in energy taxes (introduction of a coal tax and increase in the natural gas tax) and in the mineral oil tax, resulting in an additional yield of € 335 million. In 2004 the mineral oil tax will generate revenue of € 3,450 million, while the energy taxes will amount to € 790 million. With the introduction of road pricing the road use toll will be abolished, the resulting revenue shortfall of € 75 million will be partly offset by additional revenues from energy taxes. In addition, the motor vehicle tax rates will be cut. The decrease in revenues from energy taxes for the years 2002 and 2003 is due to a time lag in the re-funding procedure for enterprises, as well as to an extension of eligibility for re-funding to all energy-intensive enterprises.

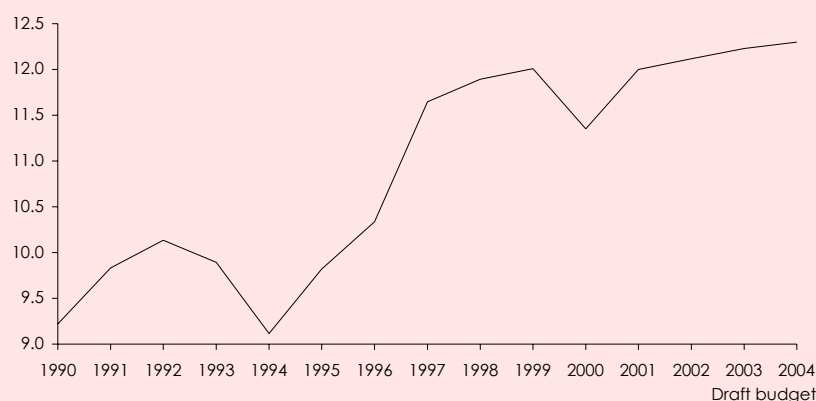
After a modest increase of 3.5 percent in the year 2002, the intake from the wage tax will rise by only 3.6 percent and 3 percent in 2003 and 2004, respectively. This development reflects the fact that wages and salaries will grow only slowly. Moreover, in 2004 the envisaged tax cuts (increase of the general tax credit, a change in phas-

Increase of environment taxes starting in 2004

Wage tax puts an increasing burden on mass income

ing-in the tax credit) will become effective and amount to € 380 million; the 2004 intake will be reduced by almost € 330 million.

Figure 2: Wage tax as percentage of gross mass income



Source: Federal Ministry of Finance, WIFO calculations.

However, wage tax revenues as a percentage of total mass income will continue to follow a long-term upward trend, rising from 9.2 percent in 1990 to 12.3 percent according to the budget for 2004. Hence, the relief produced by the 2000 income tax reform (entailing a reduction of the tax burden ratio to 11.4 percent of gross mass income) was only temporary. The first stage of the tax reform for 2004-05 will not reverse, but only dampen this rising tax burden on gross mass income. Furthermore, with 2004 the increase in environment-related taxation will generate an additional burden, which will attenuate the expansive effect of wage tax breaks on private consumption.

After a downward drift in 2002 and 2003, the corporate income and the assessed income tax yields are expected to recover in 2004. However, if the economy grows at a lower rate than assumed in the budget, the increase in income tax revenue envisaged for 2004 could fall short of expectations.

On the basis of the budgets for 2003-04, the tax structure undergoes a significant shift in the period from 2001 to 2004: taxes on income lose markedly in importance. While in 2001 their share reached a long-term peak, accounting for 50.8 percent of gross total tax revenues, this figure is projected to fall to 47.7 percent by 2004. This is a reversal of the observed long-term trend regarding direct taxation. Correspondingly, the share of tax revenues from expenditure and consumption will rise from 47.1 percent (2001) to 50.3 percent (2004) of total gross tax revenues. This structural shift is due not only to the sluggish economic growth, but also to the relief measures within direct taxes and to increases in indirect taxes. In addition to the increase in environment-related tax receipts that has been noted above, this development is fuelled by a rise in the tobacco tax intake: after a growth of 5.1 percent in 2002 due to a price hike, the increase in tobacco tax rates in 2003 is expected to further boost these receipts by 4.1 percent.

While higher taxation of fossil fuels, starting in 2004, will strengthen the ecological elements of the tax system, so far no clear increase in the importance of environment taxes can be observed. At 6 percent of total tax revenues, receipts from the mineral oil tax in 2003 and 2004 will just recover to the level of 1995. The share of energy taxes in total tax revenues is expected to increase slightly from 1.3 percent in 2001 to 1.4 percent in 2004.

Finally, the share of property tax receipts in total tax intake will continue to remain marginal, at 1.3 percent in 2003 and 1.2 percent in 2004. Within property-related taxes, the property acquisition tax has the largest quantitative significance.

Since direct tax revenues are more elastic than indirect tax revenues (Lehner, 2002), the structural shift in tax revenues tends to weaken the effect of automatic stabilis-

Tax revenue relies increasingly on indirect taxation

ers, and to reduce the revenue elasticity of the whole tax system. Further tax measures that are likely to be implemented within the second stage of the tax reform as of 2005 (cut in the corporate income tax rate, further personal income tax cuts), will enforce this structural shift.

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Federal Budget 2003-04: Postponing the Goal of a Balanced Budget – Summary

In view of the fact that extensive tax relief measures have been envisaged for the tax reform of 2004-05, and since the economy continues its modest growth rate, the federal government decided to postpone its goal of achieving a "zero deficit" beyond 2007.

The budgets for 2003 and 2004 reflect the federal government's temporary deviation from its goal of balancing the budgets for all levels of government (including states, municipalities, funds and social insurance), the achievement of which has been postponed beyond 2007. Already in 2002, the effort to balance the budget failed due to the weak overall economic situation (which resulted in increased unemployment expenditure and loss of tax revenues) and the flood of the summer of 2002. The budgets for 2003 and 2004 project an overall deficit of 1.3 percent and 0.7 percent of GDP. These deficits are caused by the sluggish economy and tax cuts as a first step of the tax reform to be implemented in 2004.

Given the ongoing stagnation of the Austrian economy it is reasonable to tolerate the effects of automatic stabilisers and therefore to increase public deficits for as long as the economy continues to be weak. This line of thought characterised the budgets for 2002 and 2003 where no attempts were made to compensate shrinking tax revenues by tax increases and expenditure cuts that would have further dampened overall demand. The budget for 2004, on the other hand, must be expected to have a rather contractive effect.

With regard to federal expenditure and revenues, the budgets for 2003 and 2004 clearly indicate structural shifts. The rise in the share of transfers as a proportion of overall spending, a long-term trend, is to be stopped in 2004, as payments related to old-age pensions are reduced. Within the category of transfer payments, expenditure related to old-age pensions is losing its foremost position, owing to the pension reforms of 2000 and 2003. In contrast, spending on families is surging. Tax revenues as a percentage of overall federal income are once again up in 2004, while simultaneously overall tax revenues increasingly rely on indirect taxes.